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SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1941

NO.

KEYSTONE AUTOMOBILE CLUB CASUALTY CO.,
Petitioner on Review,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent on Review,

KEYSTONE AUTOMOBILE CLUB FIRE CO.,
Petitioner on Review,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent on Review.

Petition for writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your Petitioners, the Keystone Automobile Club Casualty Company and the Keystone Automobile Club Fire Company, respectfully pray that a Writ of Certiorari issue to the Circuit Court of Appeals for the Third Circuit to review a judgment of that Court in the above entitled cause, entered on October 30, 1941.

Opinions Below

The United States Board of Tax Appeals promulgated two Opinions in the case separated by a period of one year. The Original Opinion was promulgated July 27, 1939 and was reported at 40 B. T. A. 291 (R. 1-25). The Original Opinion was modified by a Supplemental Opinion promulgated July 16, 1940 and reported at 42 B. T. A. 356 (R. 77-81). The Opinion of the United States Circuit Court of Appeals is reported at 122 Fed. (2nd) 886 (R. 304-312).

Jurisdiction

Petition for Rehearing was denied by the Circuit Court of Appeals on October 30, 1941 (R. 328). The jurisdiction of this Court is evoked under Section 240 of the Judicial Code as amended by the Act of February 13, 1925, c. 229, §1, 43 Stat. 938, 28 U. S. C. A. §347.

Questions Presented

1. Is Article 1014 of Treasury Regulations 74, which provides that:

> "* * * A stock fire insurance company, operated on the mutual plan to the extent of paying dividends to certain classes of policyholders, may make a return on the same basis as a mutual fire insurance com-

pany with respect to its business conducted on the mutual plan."

a valid regulations under Section 208 (c) (3) of the Revenue Act of 1928 and the corresponding sections of subsequent Revenue Acts?

2. Did Congress by the reenactment of Section 234 (a) (14), Revenue Act of 1918 in identical words in the subsequent Revenue Acts of 1921 (Sec. 234 (a) (13)), 1924 (Sec. 234 (a) (11)), 1926 (Sec. 234 (a) (11)), 1928 (Sec. 208 (c) (3)), 1932 (Sec. 208 (c) (3)), 1934 (Sec. 207 (c) (3)), 1936 (Sec. 207 (c) (3)), 1938 (Sec. 207 (c) (3)), and Sec. 207 (c) (3) of the Internal Revenue Code, approve and adopt the aforesaid administrative Regulation originally promulgated in the year 1920 in Regulations 45 and continued in force under all of the subsequent Revenue Acts referred to?

Statutes and Regulations Involved

Section 208 (c) (3) of the Revenue Acts of 1928 and 1932 and Section 207 (c) (3) of the Revenue Act of 1934 permits deductions as follows:

"In the case of mutual insurance companies (including interinsurers and reciprocal underwriters, but not including mutual life or mutual marine insurance companies) requiring their members to make premium deposits to provide for losses and expenses, the amount of premium deposits returned to their policyholders and the amount of premium deposits retained for the payment of losses, expenses and reinsurance reserves."

Article 1014 of Regulations 74 and 77 and Article 207-5 of Regulations 86 (as amended by T. D. 4697—September 22, 1936—XV-2 C. B. 167), provide:

> "* * * A stock fire insurance company, operated on the mutual plan to the extent of paying dividends to certain classes of policyholders, may make a return on the same basis as a mutual fire insurance company with respect to its business conducted on the mutual plan".

The sections of all the Revenue Acts referred to above are quoted in full in the Appendix to the Brief accompanying this Petition, pp. 29 to 35.

All regulations referred to above are quoted in full in the said Appendix, pp. 35 to 43.

Statement of the Case

This was an action by the Keystone Automobile Club Casualty Company and the Keystone Automobile Club Fire Company against the Commissioner of Internal Revenue to review the decisions of the United States Board of Tax Appeals covering the taxable years 1929 to 1935, inclusive and entered of record as of July 17, 1940 (R. pp. J to L). These decisions were affirmed by the Circuit Court of Appeals for the Third Circuit in an Opinion filed September 10, 1941 (R. 304-312), and a Petition for Rehearing was denied by that Court on October 30, 1941 (R. 328). The following deficiencies were determined by the Board of Tax Appeals and affirmed by the Circuit Court (R. 2, 312):

Keystone Automobile Club Casualty Co.

Year	*Income Tax*
1929	$ 6,796.46
1930	9,554.06
1931	4,330.12
1932	48,824.29
1933	45,546.00
1934	.....
1935	12,418.87
Total	$127,469.80

Keystone Automobile Club Fire Co.

Year	*Income Tax*
1929	$ 9,232.12
1930	8,044.91
1931	5,392.74
1932	3,753.58
1933	3,770.47
1934	5,213.01
1935	4,454.43
Total	$39,861.26

The deficiencies, determined by the Board for the years involved and affirmed by the Circuit Court, were computed on the basis of net taxable income substantially the same in amounts as the amounts of deductions taken on the returns for "premium deposits retained for the payment of losses, expenses and reinsurance reserves." This is illustrated by the following table:

Casualty Company

Year	*Amounts Deducted on Return as Premium Deposits Retained and Credited to Contingent Reserve*	*Net Taxable Income as Determined by Commissioner*
1929	$57,518.42	$61,785.99
1930	72,532.14	79,617.14
1931	34,825.48	36,084.35
1932	357,844.82	355,085.77
1933	335,309.46	331,243.61
1934	(-7,339.95)	(-36,008.18) (Loss)
1935	90,626.41	90,319.06

Fire Company

1929	83,928.40	83,928.40
1930	66,800.91	67,040.91
1931	44,644.20	44,939.52
1932	27,298.77	27,298.77
1933	27,367.63	27,421.63
1934	40,662.97	37,912.82
1935	32,395.84	32,395.84

The differences as shown in the two columns above are due to the inclusion or exclusion of minor items by the Commissioner and the Petitioners. (Statistical Table, R. 137; Pet. Exh. 64, R. 138).

In the Original Opinion the Board allowed the deduction for the amount of "premium deposits returned" to policyholders, but disallowed the deduction for "premium deposits retained" on the grounds that the evidence did not show that the premium deposits had been retained to pay "incurred" losses and "accrued" expenses in accordance with the interpretation of Section 207 (c) (3) of the Reve-

nue Act of 1934 as set forth in Article 207-1, Regulations 86, as originally promulgated February 11, 1935.

This article of Regulations 86 containing the said provision setting forth said definition, however, was *revoked* retroactively as of the date of its issue by Treasury Decision 4697 approved September 22, 1936. Treasury Decision 4697 (XV-2 CB-167) restored the former articles theretofore in force, and which had previously appeared as Articles 1011 to 1015, inclusive, in Regulations 74 and 77 and which have since been in force in Regulations 86 and subsequent regulations as Articles 207-1 to 207-7, inclusive. The regulation of February 11, 1935 could, therefore, furnish no ground for the Board's decision. The same interpretation of the term "premium deposits retained" which had been in force since 1918, and which had been repromulgated in each of the successive sets of Income Tax Regulations 45, 62, 65, 69, 74 and 77 (Acts of 1918 to 1932, inclusive), was thus expressly restored and continued in Regulations 86, and has also been continued in Income Tax Regulations 94, 101 and 103 (Acts of 1936 to 1941, inclusive).

The only hiatus in the continuity of the interpretation of Section 208 (c) (3) of the Revenue Act of 1928 and the corresponding sections of prior and subsequent revenue acts, was expressed by the applicable articles of regulations promulgated by the Secretary of the Treasury which appeared in Regulations 86, Article 207-1 (1934 Act), and which were thereafter retroactively revoked. From 1918 to date (1941) there has been no substantial change in the sections of revenue acts applicable to the allowance of special deductions permitted "Mutual Insurance Companies Other than Life" which are taxable.

The Commissioner issued, on or about August 1, 1935, an Office Decision which provided that the application of Article 207-1, Regulations 86 (as originally promulgated) should be confined to returns for taxable years beginning after December 31, 1933 (I. T. 2907, XIV-2 C. B. 150). The Board in its Original Opinion applied the revoked interpre-

tation to the years 1929 to 1933 as well as to 1934 and 1935.

The error of the Board in the Original Opinion was so flagrantly obvious, that Petitioners' counsel immediately directed the attention of the Member responsible for the Opinion to the error, according the opportunity for correction by the Board itself, in preference to a prompt filing of a Petition for Review and a correction of the error in the Circuit Court.

The Member recognized the error and ordered the decisions vacated, but it was too late at that time to withdraw the Opinion due to its official publication.

At the direction of the Board a further hearing was held October 4, 1939, but the introduction of further evidence was not permitted. The Board promulgated a Supplemental Opinion July 17, 1940, same being reported at 42 B. T. A. 356.

The Supplemental Opinion (R. 77-81) did not change the Findings of Fact as set out in the Original Opinion (R. 1-25). It reaffirmed that both Petitioners, while organized as stock companies, were operated on a mutual plan for the sole benefit of the policyholders (R. 7, 15, 78), and without any profit whatever for the sole stockholder, i. e., the Club (R. 15); that all policyholders were treated exactly alike and like refunds of premium deposits paid to all classes of policyholders (R. 15); it restated that both Petitioners were entitled to take as deductions under the terms of Article 1014, Regulations 74 (Act of 1928) and corresponding articles of Regulations 77 (Act of 1932) and 86 (Act of 1934) the amounts of premium deposits returned to policyholders (R. 78, 79). As to the Petitioners' right to take as a deduction premium deposits retained for the payment of future losses and expenses (and not "incurred" losses and "accrued" expenses), the Board affirmed its Original Opinion (which it admitted was based on error) through the process of a resort to the evidence, stating:

> "* * * that the premium deposits on hand at the end of the taxable years are not shown to have been re-

tained for the payment of losses, expenses, and reinsurance reserves." (R. 79).

The Circuit Court of Appeals affirmed the Board's decisions on entirely different grounds. It held that the Petitioners were not mutuals for "exemption" purposes and that if a company did not meet the tests of a "mutual" for exemption purposes, it likewise could not meet the tests for the purposes of the special deduction for "premium deposits retained" allowed taxable "mutuals" under the provisions of Section 208 (c) (3), Revenue Acts of 1928 and 1932, and Section 207 (c) (3), Revenue Act of 1934. It further held that that part of Article 1014, Regulations 74 and 77, and Article 207-5, Regulations 86, as amended, which had been in force since 1918 and which allowed stock fire and casualty insurance companies operated on the mutual plan to the extent of paying dividends to certain classes of policyholders to make returns on the same basis as mutual fire and casualty insurance companies, was ineffective because this regulation amended the statute by granting a deduction for which the statute made no provision.

Reasons Relied on for the Allowance of the Writ

1. This is a case of first instance and the Circuit Court of Appeals has decided an important question of Federal law which has not been, but should be, settled by this Court.

This Court's attention is called to the fact that that part of Article 1014, Regulations 74, and which is here pertinent (see pp. 2, 3, this Petition), has been in effect for twenty (20) years under the ten (10) different Revenue Acts. The Commissioner of Internal Revenue did not pro-

test its validity either before the Board or before the Circuit Court of Appeals, nor did the Board question its validity in either its Original or Supplemental Opinions (R. 1-25 and 77-81).

2. The Circuit Court of Appeals has decided a Federal question in a way probably in conflict with applicable decisions of this Court, and has not given proper effect to the applicable decisions of this Court.

This Court's attention is called to the fact that the decision of the Circuit Court of Appeals on the question here presented is in conflict with decisions of this Court in the cases of *Koshland* v. *Helvering,* 298 U. S. 441; *Commissioner* v. *Oregon Mutual Life Ins. Co.,* 311 U. S. 267; *Reynolds Tobacco Co.* v. *Helvering,* 306 U. S. 110; *Provost* v. *U. S.,* 267 U. S. 443; *Pink, Supt.* v. *AAA Highway Express, etc.,* 62 Sup. Ct. Rep. 241 (decided December 8, 1941).

3. The Board of Tax Appeals and the Circuit Court of Appeals both approved the deduction for "premium deposits returned to policyholders", but both the Board and the Circuit Court disallowed the deduction for "premium deposits retained to pay losses and expenses". Both deductions are allowed "mutual" insurance companies under Section 208 (c) (3), Revenue Act of 1928, and both deductions are allowed stock companies operated on the mutual plan under Article 1014, Regulations 74, and under all prior and subsequent Revenue Acts, and the corresponding articles of regulations promulgated under said Revenue Acts.

4. The case is of vital importance to all stock companies operated upon the mutual plan because of the fact that there has been a uniform interpretation of Section 208 (c) (3) of the Revenue Act of 1928 and corresponding sections of prior and subsequent revenue acts for over a period of twenty (20) years as was evidenced by Article

1014 of Regulations 74 (1928 Act) and the corresponding article appearing in all prior and subsequent regulations, and which regulation the Circuit Court of Appeals for the Third Circuit has now held invalid with respect to one deduction and approved with respect to the other deduction.

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Respondent on Review,

KEYSTONE AUTOMOBILE CLUB FIRE CO.,
Petitioner on Review,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent on Review.

Brief supporting petition for certiorari

The Petition contains a reference to the Opinions promulgated below and also references to the official reports

in each instance, a statement of the grounds on which the jurisdiction of this Court is evoked, a statement of the case, and a summary of the reasons relied on for the allowance of the writ.

ARGUMENT

Preliminary Statement

Section 208 (c) (3) of the Revenue Act of 1928, and corresponding sections of prior and subsequent revenue acts, granted special deductions to "Mutual Insurance Companies Other than Life or Marine". Those special deductions were (1) the amount of premium deposits returned to their policyholders, and (2) the amount of premium deposits retained for the payment of losses, expenses, and reinsurance reserves.

Article 1014 of Regulations 74, promulgated under the Revenue Act of 1928, and all corresponding articles of all regulations promulgated under prior and subsequent revenue acts from 1918 to 1941, inclusive, provided that a stock fire insurance company operated on the mutual plan to the extent of paying dividends to certain classes of policyholders could make their returns on the same basis as mutual fire insurance companies with respect to their business conducted on the mutual plan.

Under this regulation, the Commissioner of Internal Revenue has always accorded both stock casualty and stock fire insurance companies operated upon the mutual plan the same treatment since the 1918 Act to date. The Circuit Court of Appeals in its Opinion held that this was correct and that the regulation could make no distinction between fire insurance companies and casualty companies (R. 311).

The Board allowed the deduction for "premium deposits

returned'' to policyholders, and the Circuit Court of Appeals approved that allowance (R. 304-312).

The Circuit Court of Appeals however, held that the regulation was ineffective as to the allowance of the deduction for ''premium deposits retained'' to pay losses and expenses because it extended the right to these deductions to participating stock companies operated upon the mutual plan, which was, of course, exactly what the regulation in question had provided for twenty (20) years (R. 311).

Summary of Argument

The Circuit Court of Appeals failed to give force and effect to the fact that that part of Article 1014, which is here pertinent, had stood in the regulations unchallenged for over twenty (20) years, and was repeatedly approved by Congressional reenactment of the underlying Statute in the face of the Department's request for a change. Reenactment of the Statute under such circumstances removed whatever degree of ambiguity or doubt as to construction there might have been by declaring that ''mutual'' related to *''operation''* of the Company as distinct from *''control''* for purposes of taxation and the deductions allowed by Section 208 (c) (3). The Circuit Court of Appeals failed to give force and effect to the ''Reenactment Rule'' in holding that that part of Article 1014 of Regulations 74, pertinent to the within case, was ineffective because it extended or amended Section 208 (c) (3) and granted a deduction not provided for in the Statute. The Circuit Court of Appeals also failed to distinguish between ''mutual'' casualty and fire insurance companies for exemption purposes, as contrasted with ''mutual'' companies for taxation purposes and held that a company which could not qualify as a mutual for exemption purposes under Section 103 (11) (Revenue Act of 1928) could not qualify as a mutual for purposes of special deductions under Section 208 (c) (3) (Revenue Act of 1928).

Furthermore, if the Court recognized, as it did, the correctness of the deduction for "premium deposits returned to policyholders" under this regulation for stock companies operated on the mutual plan, the same reasoning supports the propriety of the second deduction for "premium deposits retained to pay losses and expenses".

The position taken by the Circuit Court of Appeals will result in extreme confusion and uncertainty as to the proper interpretation of Section 208 (c) (3) as it has heretofore been accepted and applied for approximately twenty (20) years, as evidenced by the Treasury's regulations in force for that period of time. An authoritative construction by this Court is most necessary.

Legislative History and Departmental Interpretation of Section 208 (c) (3), Revenue Acts of 1928 and 1932 and Section 207 (c) (3), Revenue Act of 1934

Section 208 (c) (3) and Section 207 (c) (3) grant the deduction in question to Mutual Insurance Companies Other than Life or Marine. Article 1014 does not grant any additional deductions. The pertinent part of Article 1014 which is involved in this case specifies only one type of mutual insurance company which is entitled to the deduction in question, viz., a stock company operated on the mutual plan to the extent of paying dividends to certain classes of policyholders. However, Article 1014, as a whole, specifies several types of taxable "mutuals" which are entitled to the special deductions allowed by Section 208 (c) (3).

If the term "mutual", as applied to insurance companies for Federal tax purposes, had not been of doubtful construction, then Article 1014 as a whole would never have been necessary and the Treasury Department would have had no need to promulgate it. Likewise, the Federal courts would not have been called upon over the past twenty (20) years to interpret the term "mutual" with respect

to insurance companies in connection with the various types not specified in the Department's interpretation as set forth in Article 1014.[1]
Congress thought Article 1014 was a proper interpretation of Section 208 (c) (3), and by operation of the "Reenactment Rule" approved that interpretation.

The Treasury Department promulgated this regulation containing this particular interpretation under the 1918 Act and the same wording has been contained in subsequent regulations from that time until the present date.

When the 1932 Revenue Act was pending before Congress the Treasury Department attempted to procure a radical change in Section 208 (c) (3) and to, likewise, change the interpretation of it as set forth in Article 1014. Congress refused to make the requested change and reenacted Section 208 (c) (3) in the exact words theretofore used in prior revenue acts. (Report of Senate Finance Committee—May 11, 1932, C. B.-1939-1 (Part 2) p. 523 (R. 238-240); Discussion on the Floor of the Senate re Proposed Amendment-Cong. Rec. Vol. 75, Part 9, pp. 10399-10404 to 10407-May 17, 1932 (R. 240-250); Hearings before Committee on Finance-Revenue Act of 1932 on H. R. 10236-May 20, 1932, Supplement No. 3 (R. 251-303).

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[1]Penn Mutual Co. v. Lederer, 252 U. S. 523 (1920)
Duffy v. Mutual Benefit Ins. Co., 272 U. S. 613 (1927)
Atlantic Life Ins. Co., Moncure v., 35 Fed. (2) 360—D.C.E.D. Va. (1929)
Mutual Assurance Soc. of Va. v. Com., 24 BTA 1102 (acquiesced by Commissioner XI-2 CB-7) (1931)
Baltimore Equitable Assn. v. U. S., 3 Fed. Supp. 427 (Ct. Cl.) (1933)
MacLaughlin v. Phila. Contributionship, Etc., 73 Fed. (2nd) 582, (CCA-3) (1935)
National Grange Mutual Liability Co. v. Com., 80 Fed. (2) 316, (CCA-1) (1935)
Baltimore Equitable Assn. v. U. S., 17 Fed. Supp. 17 (Ct. Cl.) (1936)
Geo. A. Peak v. Comm., 80 Fed (2) 761, (CCA-8) (1936)
Equitable Life Assur. Society v. Bowers, 87 Fed. (2) 687, (CCA-2) (1937)
Driscoll v. Washington Co. Fire Ins. Co., 110 Fed. (2) 485, (CCA-3) (1940)
Ohio Farmers Indemnity Co. v. Com., 108 Fed. (2) 665, (CCA-6) (1940)
Helvering v. Oregon Mutual Life Ins. Co., 311 U. S. 267 (1940)
Pink v. AAA Highway Express, Etc., 62 Sup. Ct. Rep. 241 (1941)

It must be presumed that in so doing Congress had the construction of this section as set forth in Article 1014 in mind. The Treasury Department has never repudiated this interpretation and did not repudiate it at any time during the conduct of this case before either the Board of Tax Appeals or the Circuit Court.

Under Section 208 (c) of the Revenue Acts of 1928 and 1932, the Treasury Department had promulgated Articles 1011 to 1015, inclusive, in Regulations 74 and 77, respectively, for the purpose of interpreting that section of the said revenue acts.

When Regulations 86 (Revenue Act of 1934) were originally promulgated on February 11, 1935, it was found that the Department had completely rewritten the regulations interpreting the corresponding section of the Revenue Act of 1932. Instead of having five (5) separate articles, the Department's interpretation was condensed into one article designated as Article 207-1, Regulations 86. This regulation attempted to interpret Section 207 (c), Revenue Act of 1934, in exactly the same manner as the Treasury had suggested to Congress to change the statute itself and which change had been rejected at the time of the passage of the Revenue Act of 1932.

A tremendous opposition developed on the part of Mutual Insurance Companies Other than Life and Marine and Stock Insurance Companies Other Than Life and Marine operated on the mutual plan to this patent attempt on the part of the Treasury Department to accomplish through regulations what it had failed to accomplish when Congress refused to make the changes in the statute itself. As a result of these protests, Treasury Decision 4697, issued September 22, 1936, revoked Article 207-1 of Regulations 86, as it was originally promulgated, and restored the previous regulations interpreting this section as Articles 207-1 to 207-6, inclusive.

Article 207-5, a part of the said Treasury Decision and a part of the restored regulations, contained the identical provision with respect to the allowance as a deduction of

the amount of premium deposits retained by a stock fire insurance company operated on the mutual plan as originally set forth in Article 1014 of Regulations 74 and 77.

Analysis of Position Taken by Circuit Court of Appeals

Judge Goodrich, in referring to the exemption issue raised before the Circuit Court of Appeals but not raised in this Petition for a Writ of Certiorari, said (R. 307):

> "* * * * * * * * * * *
>
> The Court finds it unnecessary to determine whether the Petitioners have retained income for premium deposits for the purpose of paying losses or expenses because of the conclusion of the Court that the Petitioners are not mutual insurance companies."

In referring to the Petitioners' rights to the special deductions allowed Mutual Insurance Companies Other than Life under the provisions of Section 208 (c) (3) of the Revenue Acts of 1928 and 1932 and Section 207 (c) (3) of the Revenue Act of 1934, and as allowed under the interpretation of the Treasury Department expressed in Article 1014 of Regulations 74 and corresponding articles of subsequent regulations, Judge Goodrich also said (R. 311):

> "* * * * * * If the regulation purports to extend the statute by making it applicable to non-mutual insurance companies to the extent that they write participating policies the Court, likewise, thinks it is ineffective. The Act is clear that the provisions here involved are applicable only to mutual insurance companies. Regulations cannot amend the statute by granting an exemption or deduction for which the statute makes no provision.
>
> * * *
>
> The Petitioners, therefore, can get no relief from

the regulations, assuming that it is subject to the construction for which they contend. * * * * * * *"

The Circuit Court of Appeals has, therefore, held that an insurance company, casualty or fire, which is not a "mutual" for *exemption purposes* is, likewise, not a "mutual" for *taxation purposes,* and in support thereof has cited the case of the *Baltimore Equitable Soc.* v. *U. S.,* 3 F. Supp. 427 (Ct. Cl. 1933) Cert. den. 290 U. S. 662 (1933) (see footnote in Circuit Court's Opinion—R. 311).

The Circuit Court of Appeals has also held that Article 1014 of Regulations 74 and the correspoonding articles of Regulations 77 and 86 are invalid only insofar as those articles allow a deduction for "premium deposits retained", under Section 208 (c) (3) of the Revenue Act of 1928 and 1932 and Section 207 (c) (3) of the Revenue Act of 1934, to stock casualty and stock fire insurance companies operated on the mutual plan to the extent of paying dividends to certain or all classes of policyholders, and has cited Mr. Justice Roberts' Opinion in the case of *Koshland* v. *Helvering,* 298 U. S. 411, in support thereof.

Analysis of the Baltimore Equitable Society Case

Baltimore Equitable Society, v. *U. S.,* 3 Fed. Supp. 427 (Ct. of Cls.) was decided May 8, 1933. That case is not an authority on the issue raised herein, and is clearly distinguishable in every respect.

That Company claimed exemption from income taxes under the provisions of Section 103 (11), Act of 1928, and corresponding sections of prior Revenue Acts.

The Baltimore Equitable Society was organized as a mutual fire insurance society under the laws of the State of Maryland, and was engaged in the business of insuring members against loss by fire. The method employed by the Society was to require a deposit by members of the full, estimated premium, against which was charged the pro-

portionate losses of the company and to which were credited the proportionate dividends and profits. The members could withdraw the remainder of their deposits upon cancellation of their policies whenever demanded. Insurance, as originally written by the Society, was for a 7-year period. Subsequently, this was changed, to perpetual insurance. In addition to this type of insurance, the taxpayer also issued "term" insurance at a fixed premium for a period less than seven years. This "term" insurance constituted about 10% of the total insurance written by the Society. It was held by the Court of Claims that such non-assessable term insurance issued for a fixed premium was not mutual insurance, and that the taxpayer was not entitled to the exemption granted mutual insurance companies. In reaching this conclusion, the Court of Claims said in part as follows:

> "As to those who received this term insurance at a fixed premium, there was no mutuality. They paid in advance for their insurance, and that was the end of all payments and liabilities so far as they were concerned. * * * They were not members, were not entitled to any refund of premiums paid upon surrender or cancellation of their policies, or to share in the distribution of earnings and profits of the company. In short, so far as those who held policies for term insurance was concerned, there was no mutuality."

The Court of Claims in the Baltimore Equitable Society case, said that exemption applied only to mutual insurance companies that were "purely mutual". In using the word "purely", there is no doubt that the Court meant "entirely", and then only with respect to the kind of insurance written. The company in question had been writing 90% mutual insurance or participating insurance and 10% non-mutual or non-participating insurance. The Court of Claims in distinguishing between exempt Building & Loan Associations and Mutual Insurance Companies, wherein part of

the Building & Loan Association's business was not conducted on a mutual basis, said:

> "But in the instant case the term insurance, while written for non-members was insurance business nevertheless, and as we construe the statute, in order to be entitled to exemption the plaintiff must show that the insurance business was conducted on a mutual basis. This was clearly not the case as to the policyholders who took out term insurance. They were not members, were not entitled to any refund of premiums paid upon the surrender or cancellation of their policies, or to share in the distribution of the earnings and profits of the company. In short, so far as those who held policies for term insurance were concerned, there was no mutuality."

The Circuit Court of Appeals for the Third Circuit, in the Philadelphia Contributionship case, decided September 27, 1934, refused to accept the language or follow the decision of the Court of Claims in the Baltimore Equitable Society case, 3 Fed. Supp. 427, decided May 8, 1933.

Yet in the Keystone case the Third Circuit quotes with approval from the same Baltimore Equitable Society case decided by the Court of Claims. That case, however, deals only with the question of "mutual" companies that meet the requirements of the exemption section of the Income Tax Laws (Section 103 (11), Revenue Act of 1928), and does not deal in any way with "mutual" companies subject to taxation and entitled to the deductions provided for under Section 208 (c) (3), Revenue Act of 1928.

However, the very part of the decision of the Court of Claims which is quoted by Judge Goodrich (see footnote in Circuit Court's Opinion, R. 311) fails completely as an authority against Petitioners' contentions.

Briefly, the Court of Claims said that the Baltimore Equitable Society could not write 90% participating or mutual insurance and 10% non-participating or term insurance, and claim exemption, for the reason that all policy-

holders were not treated alike and that insofar as those who held policies for term insurance were concerned, there was no mutuality. In the Keystone case all policyholders were treated exactly alike (R. 7) and, therefore, the Petitioners did meet fully that particular requirement which the Court of Claims stated as necessary for exemption, and which requirement formed the basis of the decision on the only issue before the Court of Claims in that case, viz., exemption.

The question which the Circuit Court of Appeals was deciding in the Keystone case with respect to the issues raised before that Court was not one of exemption of a Mutual Insurance Company but was whether the Petitioners, as stock companies operated upon the mutual plan, were entitled to the deductions allowed taxable Mutual Insurance Companies under the provisions of Section 208 (c) (3), Revenue Act of 1928, and Article 1014, Regulations 74, promulgated thereunder.

That regulation provided:

> "* * * A stock fire insurance company, operated on the mutual plan to the extent of paying dividends to certain classes of policyholders, may make a return on the same basis as a mutual fire insurance company with respect to its business conducted on the mutual plan."

The Circuit Court in the Keystone case definitely recognized the fact that an ordinary capital stock company might, in fact, be held a mutual company under Federal Tax Laws (R. 310).

Assuming that the decision of the Court of Claims in the Baltimore Equitable Society case was correct in holding that that Society was not exempt because it wrote 90% participating insurance and 10% non-participating or term insurance, such did not preclude the said Society, as a taxable Mutual Insurance Company, from filing its returns as a mutual company and claiming deductions in accordance

with the provisions of Section 208 (c) (3), Revenue Act of 1928, and Article 1014 of Regulations 74. Nothing on the record in that case shows that that Company did not do this very thing, and if it did not do so it could have done so. The Baltimore Equitable Society in filing a return as a taxable Mutual Insurance Company would have been entitled to take deductions for premium deposits "returned" and premium deposits "retained", to the extent that its business was conducted on the mutual plan.

In the Baltimore Equitable Society case, the Court of Claims disallowed that Company's claim for exemption, not because of the fact that it was not a mutual but because of the fact that the Court found that part of the insurance which was written by that Company was not written on a mutual basis. The 10% non-mutual or non-participating insurance, which was written at a fixed cash premium for a stated term, was written for policyholders who were not considered members. According to the Court of Claims they were not members for the reason that they could never obtain at the end of any policy year refunds from any unused portions of the premiums so paid, nor could they ever receive a pro rata refund from the accumulated reserves should the Company ever be liquidated. The Court of Claims said that this proved that these particular policyholders were not members for the reason that with respect to this particular term insurance which sold at a fixed premium, there was no mutuality.

However, in the case of *Pink* v. *AAA Highway Express, etc.*, 62 Sup. Ct. Rep. 241, decided by this Court on December 8, 1941, it was held that all policyholders of a mutual insurance company did not necessarily have to be members. Based on this decision by this Court it would appear to follow that if all policyholders do not have to be members in a mutual company, the fact that some of the policyholders are not members does not prevent the Company from being a mutual. This being so, it would follow that the fact that some policyholders of the Keystone Automobile Club Casualty Company and the Keystone Automobile

Club Fire Company were only associate members of the Keystone Automobile Club, and, therefore, did not share in the control of the Club and the Insurance Companies unless they choose to pay dues (R. 306) and became active members in the Club, would not preclude said Insurance Companies from being mutual companies, if they otherwise operated on the mutual plan. However, whether actually and strictly mutual companies for exemption purposes or not, it could make no difference for the purpose of obtaining the special deductions allowed under the sections of the Acts and by the articles of the Regulations here involved. Article 1014 of Regulations 74 and corresponding articles in all other Income Tax Regulations granted, and still grant, said special deductions to stock casualty and stock fire insurance companies operated upon the mutual plan by permitting such companies operated on the mutual plan to the extent of paying dividends to certain classes of policyholders to make a return on the same basis as a mutual company. The Keystone Companies paid dividends or returned premium deposits to all policyholders and all policyholders received the same rate of refund. (R. 6, 7, 15).

Therefore, the Baltimore Equitable Society case is no authority whatever for denying the deduction in question to the within Petitioners.

Analysis of the Koshland Case

In citing the case of *Koshland* v. *Helvering,* 298 U. S. 411, to support his position that the within Petitioners were not entitled, under the provisions of Article 1014, Regulations 74, to the deduction for "premium deposits retained", Judge Goodrich quoted from Mr. Justice Roberts' Opinion in the said case as follows:

> "When the Act uses ambiguous terms, or is of doubtfull construction, a clarifying regulation or one indicat-

> ing the method of its application to specific cases not only is permissible but is to be given great weight by the Courts. And the same principle governs where the statute merely expresses a general rule and invests the Secretary of the Treasury with authority to promulgate regulations appropriate to its enforcement. But where, as in this case, the provisions of the Act are unambiguous, and its directions specific, there is no power to amend it by regulation".

But Mr. Justice Roberts had earlier in his Opinion prefaced the language quoted by Judge Goodrich by the following statement:

> "* * * * * * * * * * *
>
> We give great weight to an administrative interpretation long and consistently followed, particularly when Congress presumably with that construction in mind, has reenacted the statute without change. The question here, however, is not merely of our adopting the administrative construction but whether it should be adopted if in effect it converts an income tax into a capital levy.
>
> * * * * * * * * *".

No similar reason exists in the present case for disregarding the "reenactment rule". As a matter of fact, as has been shown above, Congress reenacted the particular section in question as it had theretofore been in force for a long period of time and has refused to adopt any change therein as recommended by the Treasury at the time of the passage of the 1932 Act. This definitely established Congressional approval of Article 1014, Regulations 74, promulgated thereunder. The conclusion reached by the Circuit Court of Appeals in its Opinion is in direct conflict with the cases of *Commissioner* v. *Oregon Mutual Ins. Co.*, 311 U. S. 267; *Reynolds Tobacco Co.* v. *Helvering*, 306 U. S. 110; *Provost* v. *U. S.*, 269 U. S. 443; *Smietanka* v. *First Trust &*

Savings Bank, 257 U. S. 602; *U. S.* v. *G. Galk & Bros.,* 204 U. S. 143.

The statement of this Court with respect to the "reenactment rule" in its Opinion in the Reynolds Tobacco Co. case, supra, applies with equal force in the present case. That statement was as follows:

> "The administrative construction embodied in the regulation has, since at least 1920, been uniform with respect to each of the revenue acts from that of 1913 to that of 1932, as evidenced by Treasury rulings and regulations and decisions of the Board of Tax Appeals. In the meantime successive revenue acts have reenacted, without alteration, the definition of gross income as it stood in the Acts of 1931, 1916 and 1918. Under the established rule Congress must be taken to have approved the administrative construction and thereby to have given it the force of law."

In the *Textile Mills Security Corporation* v. *Commissioner,* No. 34, October Term, 1941, decided December 8, 1941, the "reenactment rule" was again upheld, this time with respect to regulations interpreting the phrase "ordinary and necessary expenses". In this connection, Mr. Justice Douglas said:

> "* * * * * * The words 'ordinary and necessary' are not so clear and unambiguous in their meaning and application as to leave no room for an interpretative regulation. * * * * *"

So with respect to the phrase "mutual insurance companies", that term is not so clear and unambiguous in its meaning for Federal Tax purposes as to leave no room for an interpretative regulation. Article 1014, Regulations 74, was such a regulation and it indicated the method of application to specific cases mentioned in the said article. Congress approved this interpretation and these applications by reenacting into ten (10) consecutive revenue acts

from 1918 to 1941, the section of the statute in question in identical words and the same regulation has been promulgated under each revenue act. Congress did this even after the Treasury Department had requested a change in 1932, as described above.

Judge Goodrich's Opinion in the Circuit Court of Appeals holds that the word "mutual" as describing insurance companies in connection with Federal Tax matters, is not ambiguous as a matter of law. As to the application of the "reenactment rule" under any circumstances other than one of ambiguity as a matter of law, he says nothing. Thus he confines the "reenactment rule" strictly to instances of ambiguity. However, his quotation from the Opinion of Mr. Justice Roberts in the Koshland case states definitely to the contrary.

So far as a "mutual" is concerned, which is taxable under Section 208 (c) (3) of the Revenue Act of 1928 and the corresponding sections of prior and subsequent revenue acts, the article in the regulations, which has been promulgated under the various Acts, standing unchanged for twenty (20) years and with consistent and consecutive reenactment of the statute for a like period, has removed all degree of ambiguity by declaring that "mutual" for taxation purposes meant relative to *operation,* as distinct from *control.*

This is a case of first instance and an important question of Federal law which should be settled by this Court

Section 208 (c) (3) as contained in the Revenue Act of 1928 has been identical with the corresponding section in all revenue acts from that of 1918 down to date. Article 1014, Regulations 74, as promulgated under the 1928 Act has been substantially the same under every revenue act, and insofar as the particular part of the regulation which is here involved is concerned, it has been likewise identical.

Under such conditions, after continual reenactment in

ten (10) different revenue acts and identical regulations under each Act, the validity of the regulation is challenged by the Third Circuit, despite the fact that the Treasury Department did not do so either before the Board or that Court.

Judge Goodrich in his Opinion has misapplied the case of Koshland v. Helvering, supra. He reached a conclusion in conflict with many other applicable decisions of this Court;[1] and has thereby not given proper effect to the said applicable decisions. The anomaly of the decision of the Circuit Court of Appeals is conclusively evidenced by the fact that the Commissioner, the Board of Tax Appeals and the Third Circuit Court have all allowed the deduction for "premium deposits returned to policyholders", but all have disallowed the deduction for "premium deposits retained to pay losses and expenses".

The Commissioner disallowed the second deduction without any reason. The Board of Tax Appeals first disallowed it by applying a Treasury Decision which had been revoked as of the date of its issue, and later, upon rehearing, disallowed it on evidentiary grounds. The Circuit Court of Appeals for the Third Circuit desregarded the decision of the Board of Tax Appeals entirely and disallowed the said second deduction by holding that Article 1014, Regulations 74 was invalid with respect to said second deduction, and that the "Reenactment Rule" did not apply despite the attendant facts and circumstances.

A company that qualifies for one deduction necessarily qualifies for the other, for the irrefutable reason that both deductions are allowed by the same section of the statute and by the same regulation interpreting the said section of the said statute. Both deductions are allowed in accord-

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[1]Koshland v. Helvering, 298 U. S. 441
Commissioner v. Oregon Mutual Life Ins. Co., 311 U. S. 267
Reynolds Tobacco Co. v. Helvering, 306 U. S. 110
Provost v. U. S., 267 U. S. 443
Pink, Supt. v. AAA Highway Express, etc., 62 Sup. Ct. Rep. 241 (decided Dec. 8, 1941)

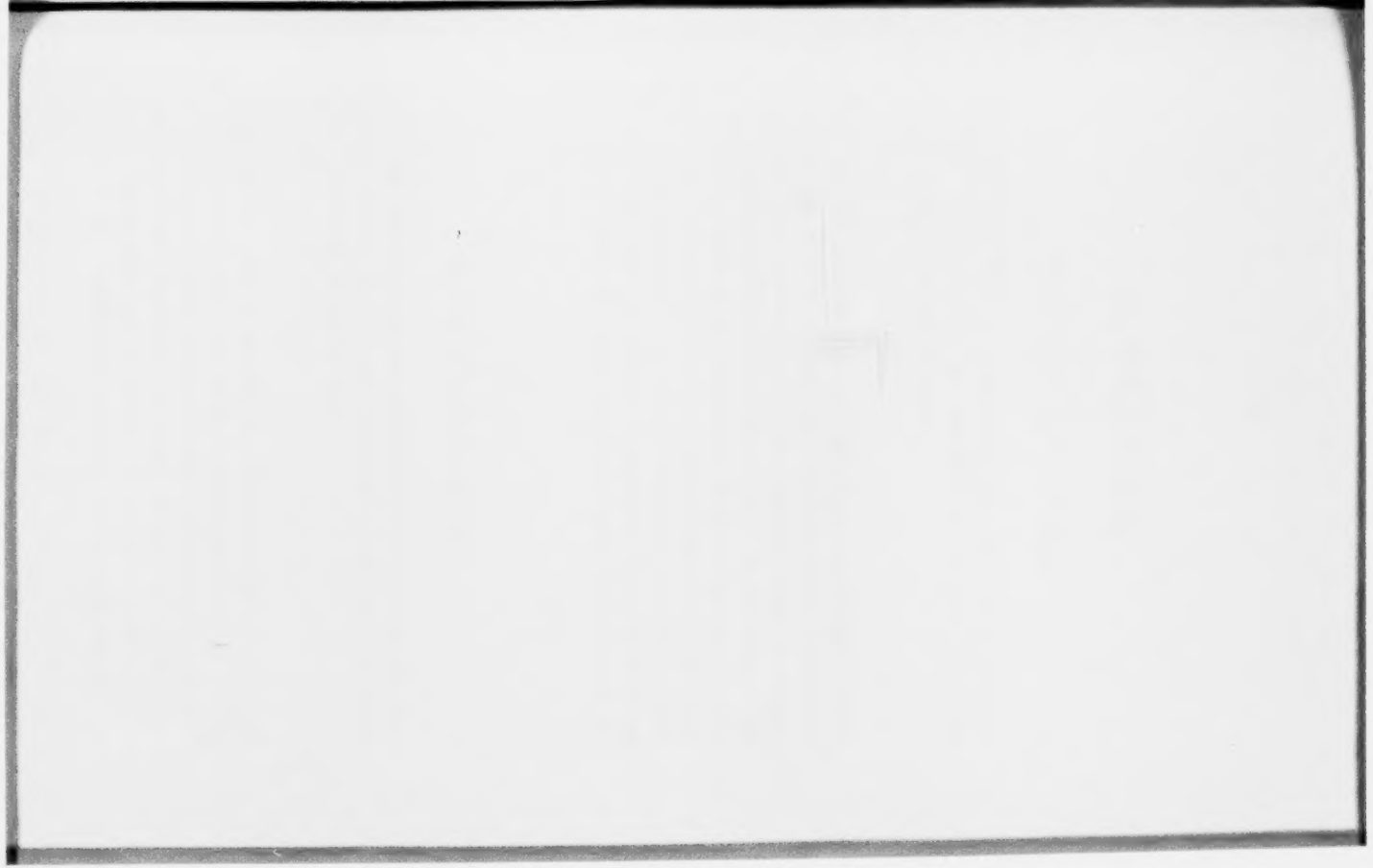
ance with the said regulation to stock companies operated upon the mutual plan.

The Petitioners were entitled to and were allowed the first deduction under the terms of the regulation as a stock company operated upon the mutual plan. They were, therefore, entitled to the second deduction. The rejectment of the "Reenactment Rule" for the purpose of disallowing the second deduction has now left the meaning of this statute in such a confused and uncertain condition as to make an authoritative construction of this Court most necessary.

We respectfully submit that the Certiorari should be granted.

R. LESTER MOORE,
Attorney for Petitioners.

JOHN W. DAVIS
TODD DANIEL
Of Counsel



APPENDIX

REVENUE ACT OF 1918

Sec. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

* * * * * *

(13) In the case of mutual insurance companies (other than mutual life or mutual marine insurance companies) requiring their members to make premium deposits to provide for losses and expenses, there shall be allowed, in addition to the deductions allowed in paragraphs (1) to (10), inclusive, (unless otherwise allowed under such paragraphs) the amount of premium deposits returned to their policyholders and the amount of premium deposits retained for the payment of losses, expenses, and reinsurance reserves;

* * * * * *

REVENUE ACT OF 1921

Sec. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

* * * * * *

(13) In the case of mutual insurance companies (including interinsurers and reciprocal underwriters, but not including mutual life or mutual marine insurance companies) requiring their members to make premium deposits to provide for losses and expenses, there shall be allowed, in addition to the deductions allowed in paragraphs (1) to

(10), inclusive, and paragraph (14), unless otherwise allowed, the amount of premium deposits returned to their policyholders and the amount of premium deposits retained for the payment of losses, expenses, and reinsurance reserves;

* * * * * *

REVENUE ACTS OF 1924 AND 1926

Sec. 234. (a) In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

* * * * * *

(11) In the case of mutual insurance companies (including interinsurers and reciprocal underwriters, but not including mutual life or mutual marine insurance companies) requiring their members to make premium deposits to provide for losses and expenses, there shall be allowed, in addition to the deductions allowed in paragraphs (1) to (9), inclusive, unless otherwise allowed, the amount of premium deposits returned to their policyholders and the amount of premium deposits retained for the payment of losses, expenses, and reinsurance reserves.

* * * * * *

REVENUE ACTS OF 1928 AND 1932

SEC. 208. MUTUAL INSURANCE COMPANIES OTHER THAN LIFE.

(a) Application of title.—Mutual insurance companies, other than life insurance companies, shall be taxable in the same manner as other corporations, except as hereinafter provided in this section.

* * * * * *

(c) Deductions.—In addition to the deductions allowed to corporations by section 23 the following deductions to insurance companies shall also be allowed, unless otherwise allowed ——

(1) MUTUAL INSURANCE COMPANIES OTHER THAN LIFE INSURANCE.—In the case of mutual insurance companies other than life insurance companies ——

(A) the net addition required by law to be made within the taxable year to reserve funds (including in the case of assessment insurance companies the actual deposit of sums with State or Territorial officers pursuant to law as additions to guarantee or reserve funds); and

(B) the sums other than dividends paid within the taxable year on policy and annuity contracts.

* * * * * *

(3) MUTUAL INSURANCE COMPANIES OTHER THAN LIFE AND MARINE.—In the case of mutual insurance companies (including interinsurers and reciprocal underwriters, but not including mutual life or mutual marine insurance companies) requiring their members to make premium deposits to provide for losses and expenses, the amount of premium deposits returned to their policyholders and the amount of premium deposits retained for the payment of losses, expenses, and reinsurance reserves.

REVENUE ACT OF 1934

SEC. 207. MUTUAL INSURANCE COMPANIES OTHER THAN LIFE.

(a) Application of title.—Mutual insurance companies, other than life insurance companies, shall be taxable in the same manner as other corporations, except as hereinafter provided in this section.

* * * * * *

(c) Deductions.—In addition to the deductions allowed to corporations by section 23 the following deductions to insurance companies shall also be allowed, unless otherwise allowed ——

(1) MUTUAL INSURANCE COMPANIES OTHER THAN LIFE INSURANCE.—In the case of mutual insurance companies other than life insurance companies —

(A) the net addition required by law to be made within the taxable year to reserve funds (including in the case of assessment insurance companies the actual deposit of sums with State or Territorial officers pursuant to law as additions to guarantee or reserve funds); and

(B) the sums other than dividends paid within the taxable year on policy and annuity contracts.

* * * * * *

(3) MUTUAL INSURANCE COMPANIES OTHER THAN LIFE AND MARINE.—In the case of mutual insurance companies (including interinsurers and reciprocal underwriters, but not including mutual life or mutual marine insurance companies) requiring their members to make premium deposits to provide for losses and expenses, the amount of premium deposits returned to their policyholders and the amount of premium deposits retained for the payment of losses, expenses, and reinsurance reserves.

REVENUE ACT OF 1936

SEC. 207. MUTUAL INSURANCE COMPANIES OTHER THAN LIFE.

(a) Application of title.—Mutual insurance companies, other than life insurance companies, shall be taxable in the same manner as other corporations, except as hereinafter provided in this section, and except that they shall not be subject to the surtax imposed by section 14, and except that

the normal tax imposed by section 13 shall be at the rate of 15 per centum instead of at the rates provided in such section, and such normal tax shall be applicable to foreign corporations as well as domestic corporations; but foreign insurance companies not carrying on an insurance business within the United States shall be taxable as other foreign corporations.

* * * * * *

(c) Deductions.—In addition to the deductions allowed to corporations by section 23 the following deductions to insurance companies shall also be allowed, unless otherwise allowed ——

(1) MUTUAL INSURANCE COMPANIES OTHER THAN LIFE INSURANCE.—In the case of mutual insurance companies other than life insurance companies —

(A) the net addition required by law to be made within the taxable year to reserve funds (including in the case of assessment insurance companies the actual deposit of sums with State or Territorial officers pursuant to law as additions to guarantee or reserve funds); and

(B) the sums other than dividends paid within the taxable year on policy and annuity contracts.

* * * * * *

(3) MUTUAL INSURANCE COMPANIES OTHER THAN LIFE AND MARINE.—In the case of mutual insurance companies (including interinsurers and reciprocal underwriters, but not including mutual life or mutual marine insurance companies) requiring their members to make premium deposits to provide for losses and expenses, the amount of premium deposits returned to their policyholders and the amount of premium deposits retained for the payment of losses, expenses, and reinsurance reserves.

REVENUE ACT OF 1938
and
PRESENT INTERNAL REVENUE CODE

SEC. 207. MUTUAL INSURANCE COMPANIES OTHER THAN LIFE.

(a) Imposition of tax.

(1) IN GENERAL.—There shall be levied, collected, and paid for each taxable year upon the special class net income of every mutual insurance company(other than life insurance company) a tax equal to 16-1/2 per centum thereof.

* * * * * *

* * * * * *

(c) Deductions.—In addition to the deductions allowed to corporations by section 23 the following deductions to insurance companies shall also be allowed, unless otherwise allowed—

(1) MUTUAL INSURANCE COMPANIES OTHER THAN LIFE INSURANCE.—In the case of mutual insurance companies other than life insurance companies—

(A) The net addition required by law to be made within the taxable year to reserve funds (including in the case of assessment insurance companies the actual deposit of sums with State or Territorial officers pursuant to law as additions to guarantee or reserve funds); and

(B) the sums other than dividends paid within the taxable year on policy and annuity contracts.

* * * * * *

(3) MUTUAL INSURANCE COMPANIES OTHER THAN LIFE AND MARINE.—In the case of mutual insurance companies (including interinsurers and reciprocal underwriters, but not including mutual life or mutual marine

insurance companies) requiring their members to make premium deposits to provide for losses and expenses, the amount of premium deposits returned to their policyholders and the amount of premium deposits retained for the payment of losses, expenses, and reinsurance reserves.

REGULATIONS

Regulations 45 (Act of 1918)—Art. 572
Regulations 62 (Act of 1921)—Art. 572

ART. 572. **Special deductions allowed mutual insurance companies.**—Mutual insurance companies (other than mutual life and mutual marine insurance companies), which require their members to make premium deposits to provide for losses and expenses, are allowed to deduct from gross income the aggregate amount of premium deposits returned to their policyholders or retained for the payment of losses, expenses, and reinsurance reserves. In determining the amount of premium deposits retained by a mutual fire or mutual casualty insurance company for the payment of losses, expenses, and reinsurance reserves, it will be presumed that losses and expenses have been paid out of earnings and profits other than premiums to the extent of such earnings and profits. If, however, any portion of such amount is applied during the taxable year to the payment of losses, expenses, or reinsurance reserves, for which a separate allowance is taken, then such portion is not deductible; and if any portion of such amount for which an allowance is taken is subsequently applied to the payment of expenses, losses, or reinsurance reserves, then such payment can not be separately deducted. An amount of premium deposits retained for the payment of expenses and losses, and the amount of such expenses and

losses, may not both be deducted. A company which invests part of the premium deposits so retained by it in interest-bearing securities may nevertheless deduct such part, but not the interest received on such securities. A mutual fire insurance company which has a guaranty capital is taxed like other mutual fire insurance companies. *A stock fire insurance company, operated on the mutual plan to the extent of paying dividends to certain classes of policyholders, may make a return on the same basis as a mutual fire insurance company with respect to its business conducted on the mutual plan.* (Italics ours.)

Regulations 65 (Act of 1924)—Art. 571
Regulations 69 (Act of 1926)—Art. 571
Regulations 74 (Act of 1928)—Art. 1014
Regulations 77 (Act of 1932)—Art. 1014

ART. 571 and 1014. **Special deductions allowed mutual insurance companies.**—Mutual insurance companies (including interinsurers and reciprocal underwriters, but not including mutual life and mutual marine insurance companies), which require their members to make premium deposits to provide for losses and expenses, are allowed to deduct from gross income the aggregate amount of premium deposits returned to their policyholders or retained for the payment of losses, expenses, and reinsurance reserves. In determining the amount of premium deposits retained by a mutual fire or mutual casualty insurance company for the payment of losses, expenses, and reinsurance reserves, it will be presumed that losses and expenses have been paid out of earnings and profits other than premiums to the extent of such earnings and profits. If, however, any portion of such amount is applied during the taxable year to the payment of losses, expenses, or reinsurance reserves, for which a separate allowance is

taken, then such portion is not deductible; and if any portion of such amount for which an allowance is taken is subsequently applied to the payment of expenses, losses, or reinsurance reserves, then such payment can not be separately deducted. The amount of premium deposits retained for the payment of expenses and losses, and the amount of such expenses and losses, may not both be deducted. A company which invests part of the premium deposits so retained by it in interest-bearing securities may nevertheless deduct such part, but not the interest received on such securities. A mutual fire insurance company which has a guaranty capital is taxed like other mutual fire insurance companies. *A stock fire insurance company, operated on the mutual plan to the extent of paying dividends to certain classes of policyholders, may make a return on the same basis as a mutual fire insurance company with respect to its business conducted on the mutual plan.* (Italics ours.)

Regulations 86 (Act of 1934) as originally promulgated February 11, 1934

ART. 207-1. **Classes of mutual insurance companies other than life.**—The term, "mutual insurance companies other than life insurance companies," as used in the Act and these regulations, includes the following:

Class (a), those that operate on a limited liability basis, charging a stipulated cash premium for their policy of insurance;

Class (b), those that operate on an assessment basis,

(1) requiring deposits in advance,

(2) not requiring deposits in advance;

Class (c), reciprocal insurance exchanges or associations; and

Class (d), mutual marine insurance companies.

(A) Class (a).—Companies coming within class (a) will return the amount of net premiums written within the year in addition to the items of income which are required to be returned by corporations generally under section 22.

In addition to the deductions and credits to which corporations generally are entitled as defined and limited under sections 23, 24, and 26, insurance companies of this type are entitled to deduct from gross income the special deductions mentioned in section 207 (c) (1) (A) and (B). For a general definition of "reserve funds" see article 203 (a) (2)—1. In the case of companies falling within class (a) the only reserve fund commonly recognized is the "unearned premium" fund. Dividends are not deductible. The term "dividends" as used in section 207 (c) (1) (B) includes distributions made, and commonly referred to as dividends, by mutual insurance companies other than life, and is not limited to the definition applicable to corporations generally. (See section 115 (a).)

(B) Class (b) (1) and (2).—Companies coming within class (b) (1) and (2), if not exempt under section 101 (11), will make their returns as follows:

(I) Class (b) (1).—In addition to the items of gross income which are required to be returned by corporations generally under section 22 and the regulations thereunder companies falling under class (b) (1) will return the amount of premium deposits received or receivable during the year, depending upon the basis on which the books are kept and the returns are made, plus the amount of such deposits retained for the payment of losses, expenses and reinsurance reserves at the close of the preceding taxable year.

In addition to the deductions and credits to which corporations generally are entitled as defined and limited under section 23, 24, and 26, insurance companies of this type are entitled to deduct from gross income:

(1) The amount of premium deposits returned to policyholders during the year;

(2) The amount of premium deposits retained at

the end of the taxable year for the payment of losses, expenses and reinsurance reserves. As used in this article the term "losses" means incurred losses; the term "expenses" means accrued expenses and the term "reinsurance reserves" means the amount necesssary to reinsure outstanding policies for their unexpired terms;

(3) The actual deposit of sums, if any, made out of the income of the taxable year with State or Territorial officers pursuant to law as additions to guarantee or reserve funds.

(II) Class (b) (2).—Companies coming within class (b) (2) will include in gross income, in addition to the items of gross income which are required to be returned by corporations generally under section 22, the amount of assessments received or receivable during the year depending upon the basis on which the books are kept and the returns are made.

In addition to the deductions and credits to which corporations generally are entitled as defined and limited under section 23, 24, and 26, insurance companies of this type are entitled to deduct from gross income the amount of assessments returned to policyholders during the year and the actual deposit of sums, if any, made out of the income of the taxable year with State or Territorial officers pursuant to law as additions to guarantee or reserve funds.

(C) Class (c).—Reciprocal insurance exchanges or associations operate generally on the premium deposit plan. Such companies are subject to the same requirements, are permitted the same deductions, and will make returns under the same conditions and in the same manner as assessment premium deposit companies.

(D) Class (d).—Mutual marine insurance companies will include in gross income the amount of gross premiums collected and received by them less amounts paid for reinsurance in addition to the items of gross income required to be returned by corporations generally under section 22.

In addition to deductions and credits to which corporations generally are entitled as defined and limited under section 23, 24, and 26, and to which mutual insurance companies other than life are entitled under section 207 (c) (1) insurance companies of this type are entitled to deduct from gross income amounts repaid to policyholders and interest thereon as provided in section 207 (c) (2).

(E) General.—If the business of a mutual insurance company other than life, partakes of the character of more than one of the classes hereinabove described its aggregate income from all classes shall be determined by computing the income received from each class separately according to the method applicable to that class.

A copy of the report made to the insurance department of the State, Territory, or District of Columbia which shows the reserves used in computing the net income reported on the return shall be filed therewith. The return shall be on Form 1030.

As to the limitation on deductions generally, see section 24 (a) (5).

Mutual insurance companies other than life not coming within the specific provisions of section 207 (b) and (c) shall make their returns under the same provisions of the law and regulations and shall be taxable in the same manner as corporations generally.

Regulations 86 (Act of 1934) as amended by T.D. 4697—September 22, 1936 (XV—2 CB 167)

* * * * * * *

ART. 207-5. **Special deductions allowed mutual insurance companies.** Mutual insurance companies (including interinsurers and reciprocal underwriters, but not including mutual life and mutual marine insurance companies), which require their members to make premium deposits to pro-

vide for losses and expenses, are allowed to deduct from gross income the aggregate amount of premium deposits returned to their policyholders or retained for the payment of losses, expenses, and reinsurance reserves. In determining the amount of premium deposits retained by a mutual fire or mutual casualty insurance company for the payment of losses, expenses, and reinsurance reserves, it will be presumed that losses and expenses have been paid out of earnings and profits other than premiums to the extent of such earnings and profits. If, however, any portion of such amount is applied during the taxable year to the payment of losses, expenses, or reinsurance reserves, for which a separate allowance is taken, then such portion is not deductible; and if any portion of such amount for which an allowance is taken is subsequently applied to the payment of expenses, losses, or reinsurance reserves, then such payment can not be separately deducted. The amount of premium deposits retained for the payment of expenses and losses, and the amount of such expenses and losses, may not both be deducted. A company which invests part of the premium deposits so retained by it in interest-bearing securities may nevertheless deduct such part, but not the interest received on such securities. A mutual fire insurance company which as a guaranty capital is taxed like other mutual fire insurance companies. *A stock fire insurance company, operated on the mutual plan to the extent of paying dividends to certain classes of policyholders may make a return on the same basis as a mutual fire insurance company with respect to its business conducted on the mutual plan.* (Italics ours.)

* * * * * *

NOTE:

Only one article appeared in Regulations 86 as it was originally promulgated with respect to Section 207. T.D. 4697, issued September 22, 1936 (XV—2 CB 167), which revoked Article 201-1 as it was originally promulgated, replaced that article with six separate

articles—Article 207-1 to 207-6, inclusive. Article 207-5 as it is set out above corresponds to the articles in previous regulations set out in this Appendix.

Regulations 94 (Act of 1936)—Art. 207-6
Regulations 101 (Act of 1938)—Art. 207-6
Regulations 103 (Present Internal Revenue Code)—Sec. 19.207-6

ART. 207-6. **Special deductions allowed mutual insurance companies (other than life or marine).**—Mutual insurance companies (including interinsurers and reciprocal underwriters, but not including mutual life and mutual marine insurance companies), which require their members to make premium deposits to provide for losses and expenses, are allowed to deduct from gross income the aggregate amount of premium deposits returned to their policyholders or retained for the payment of losses, expenses, and reinsurance reserves. In determining the amount of premium deposits retained by a mutual fire or mutual casualty insurance company for the payment of losses, expenses, and reinsurance reserves, it will be presumed that losses and expenses have been paid out of earnings and profits other than premiums to the extent of such earnings and profits. If, however, any portion of such amount is applied during the taxable year to the payment of losses, expenses, or reinsurance reserves, for which a separate allowance is taken, then such portion is not deductible; and if any portion of such amount for which an allowance is taken is subsequently applied to the payment of expenses, losses, or reinsurance reserves, then such payment cannot be separately deducted. The amount of premium deposits retained for the payment of expenses and losses, and the amount of such expenses and losses, may not both be deducted. A company which invests part of the premium

deposits so retained by it in interest-bearing securities may nevertheless deduct such part, but not the interest received on such securities. A mutual fire insurance company which has a guaranty capital is taxed like other mutual fire insurance companies. *A stock fire insurance company, operated on the mutual plan to the extent of paying dividends to certain classes of policyholders, may make a return on the same basis as a mutual fire insurance company with respect to its business conducted on the mutual plan.*

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Miscellaneous:	
T. D. 4697, XV–2 Cum. Bull. 167 (1936)	18
Treasury Regulations 74:	
Arts. 1001–1015	23
Art. 1014	8
Treasury Regulations 77:	
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Treasury Regulations 86:	
Art. 207–5	8

445140—42——1

In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 905

KEYSTONE AUTOMOBILE CLUB CASUALTY CO., PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

KEYSTONE AUTOMOBILE CLUB FIRE CO., PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The original opinion of the Board of Tax Appeals (R. 1) is reported in 40 B. T. A. 291, and the supplemental opinion (R. 77) is reported in 42 B. T. A. 356. The opinion of the Circuit Court

of Appeals (R. 304–312) is reported in 122 F. (2d) 886.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on September 10, 1941 (R. 312). A petition for rehearing was denied on October 30, 1941 (R. 328). The petition for a writ of certiorari was filed on January 27, 1942. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether petitioners should be taxed, solely as stock companies under Section 204 of the Revenue Act of 1934, or whether they are entitled to have their taxes computed under Section 207 relating to "mutual" companies.

2. Whether, even if Section 207 is applicable here, petitioners may deduct under Section 207 (c) (3) the net amount added annually to a so-called contingent reserve.

STATUTES AND REGULATIONS INVOLVED

The applicable statutes and regulations are set out in the Appendix, *infra,* pp. 13–23.

STATEMENT

The petitioners herein, Keystone Automobile Club Casualty Company and Keystone Automobile Club Fire Company, hereinafter referred to as the Casualty Company and the Fire Company, were

incorporated May 31, 1928, as stock corporations under the laws of the Commonwealth of Pennsylvania. The principal offices of the companies are in Philadelphia, Pennsylvania (R. 3).

The Keystone Automobile Club, referred to as the Club, a nonprofit corporation organized to promote the interests of motorists and furnishing many facilities to its members, desired to provide automobile casualty and fire insurance as an additional service to its members. With this end in view it caused the organization on March 23, 1925, of the Insurance Exchange of Keystone Automobile Club (R. 3–4).

The membership of the Club increased rapidly. It had many members in New Jersey. A reciprocal exchange was not permitted to operate in New Jersey. To accommodate its members in New Jersey, the Club organized the Casualty Company and the Fire Company as stock companies. Since a stock insurance company under the laws of Pennsylvania could not write both casualty insurance and fire insurance, it was necessary to incorporate two companies (R. 4). The articles of agreement of the two insurance companies provide that "The plan or principle on which the business is to be conducted is the joint stock plan or principle" (R. 117, 118).

The Club paid into the treasury of the Fire and Casualty Companies $450,000, the minimum capital requirements, for which it received the entire capital stock (R. 5).

It was originally planned that the insurance companies would pay dividends to its sole stockholder, the Club, until the $450,000 advanced by it, together with interest, had been returned but this program was subsequently abandoned. The Club's investment in the companies in the amount of $450,000 has always been carried on its books at that amount and it is the present expectation of the officers that upon any liquidation of the insurance companies the Club will receive only $450,000 (R. 5).

In November 1930 the statutory capital of the Casualty Company was increased from $200,000 to $300,000 and the statutory surplus from $100,000 to $150,000. At the same time the statutory capital of the Fire Company was increased from $100,000 to $200,000 and the statutory surplus from $50,000 to $100,000. These increases in the statutory capital and surplus of the two companies were made in order to meet the requirements of the Financial Responsibility Law of the State of New York. The increases were effected by the transfer of the necessary amounts from the contingent reserve of each company to the capital and surplus accounts. A stock dividend of $100,000 was declared by each company and additional shares of stock representing the stock dividends were issued to the Club (R. 5–6).

During the tax years involved, 1929–1935, the Fire and Casualty Companies insured members of

the Club and also members of two other automobile clubs, the Delaware Automobile Association and the Pittsburgh Motor Club. On the average they insured 35,121 of the 42,493 members of the Keystone Club and, in addition, 5,171 members of the other clubs who were not members of the Keystone Club. All policyholders were treated alike [1] (R. 7).

The members of the Keystone Club elected the Club's officers and directors and they in turn elected themselves, by proxy from the Club, officers and directors of the insurance companies. Policyholders of the other two clubs had no power to vote, although it was provided that they could become members of the Keystone Club upon payment of annual dues (R. 7).

Premium income, investment income and refunds made to policyholders during the taxable years and balance sheets as of the beginning and end of the taxable period are set forth in the record (R. 8–9).

The petitioners contended (1) that they were exempt from all taxation under the revenue acts [2]

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[1] The premiums were about 10 percent less than those charged by ordinary stock companies until 1932, and were 20 percent less thereafter. Moreover, until 1932, the policyholders received refunds of 25 percent of the premiums, and 10 percent thereafter (R. 6).

[2] Petitioners claimed exemption under Section 101 (11) of the 1934 Act and the corresponding provisions in Sections 103 (11) of the Revenue Acts of 1928 and 1932. See Appendix, *infra*, p. 13.

and (2) that even if subject to tax their taxable income was completely offset by allowable deductions. The Commissioner ruled that petitioners were not exempt, but he allowed them a variety of deductions that were carried on their balance sheets under such headings as "Estimated expenses of investigation," "Commissions, brokerage, etc.," "Reinsurance," "Losses and claims," and other items that might fall within the statutory terms "losses," "expenses," and "reinsurance reserves" (R. 80). The Commissioner also allowed the companies to deduct the amounts of premium deposits returned to the policyholders, but he did not allow any deduction on account of premium deposits and income retained by the companies in a so-called contingent reserve account (R. 78–79, 138).

The Board of Tax Appeals sustained the Commissioner, holding that the companies were not exempt from taxation and that they were not entitled to deduct from gross income the annual additions to the "contingent reserve," i. e., those amounts of income, not otherwise deductible, as amounts retained "for the payment of losses, expenses, and reinsurance reserves." The Circuit Court of Appeals affirmed.

In their petitions for certiorari, petitioners apparently do not seek review of the holding that they are not exempt, but appear to contest only the ruling that they were not entitled to the deduction.

ARGUMENT

There is no conflict of decisions and there is no reason for further review of this controversy. The decision below is correct and is not in conflict, as alleged by petitioners, with the Treasury regulations.

Since petitioners do not seem to contest the ruling below that they are not exempt, there remains the problem of classifying them and determining the propriety of the deduction which they seek. Under the revenue acts, insurance companies are divided into three groups: (1) life insurance companies; (2) insurance companies other than life or mutual; and (3) mutual insurance companies other than life. These groups are taxed respectively under Sections 201, 204, and 207 of the Revenue Act of 1934.[3]

If the Government's contention that petitioners are not mutual companies is correct, and if their income must be computed solely under Section 204, then not even petitioners contend that they are entitled to the deduction sought herein.

(1) That petitioners are stock companies rather than mutual companies is clear. The companies were organized as stock companies, and their officers and directors are elected through the Club, its sole stockholder. A substantial minority of the policyholders are not members of the Club

[3] The corresponding provisions under the 1928 and 1932 Acts are in Sections 201, 204, and 208 thereof.

and therefor have no voice in the management of the affairs of the companies. Moreover, a substantial minority of the members of the Club who are not policyholders nevertheless do have a voice in the management of the companies. Although the Board found that it is the "present expectation of the officers of the company" that upon liquidation of the insurance companies, the Club will receive only its investment therein (R. 5), there is nothing to prevent a change of that "expectation" with the consequence that the Club could legally demand all of the assets, including the accumulated profits. In these circumstances, it is plain that the companies are stock companies not only in form, but also in substance.

(2) Petitioners nevertheless contend that they are entitled to have their income computed under Section 207 relating to mutual companies, and they rely upon the provisions of Article 207–5 of Regulations 86, as amended (and corresponding provisions found in Article 1014 of Regulations 74 and 77), which read as follows:

> A stock fire insurance company, operated on the mutual plan to the extent of paying dividends to certain classes of policyholders, may make a return on the same basis as a mutual fire insurance company with respect to its business conducted on the mutual plan.

Petitioners raise sweeping questions as to the validity of these regulations. We respectfully submit that no such sweeping questions are present in this case, first, because the regulations are inapplicable, and second, because petitioners would nevertheless not be entitled to the claimed deduction in any event under Section 207 relating to mutual companies, even if the regulations were applicable.

(a) Wholly apart from the fact that these regulations deal only with a fire insurance company, and therefore could not be applicable to the Casualty Company in any event, they are inapplicable to both companies because they speak of a company "operated on the mutual plan to the extent of paying dividends to certain classes of policyholders." These regulations contemplate that even in a stock company it may be possible to carve out and segregate a portion of the business as being conducted upon a mutual basis. But, as held by the court below, petitioners' business was not conducted on a mutual basis. Large amounts of profit had been permitted to accumulate, and the sole stockholder, as such, was alone entitled to those assets upon dissolution. A substantial number of members of the Club who were not policyholders would benefit indirectly in those circumstances, and indeed, the composition of the Club at the time of any such possible future dissolution might conceivably be such as to embrace

comparatively few of the policyholders whose contributions over the period of years were responsible for the accumulated profits. These companies were not operated upon a mutual basis within the meaning of the regulations, which were intended merely to govern those cases in which a portion of a company's business could be segregated and treated differently. The absence of mutuality here goes to the entire enterprise. The regulations are not applicable, and there is therefore no basis for petitioners' contention that the decision below is contrary to Treasury practice of long standing.

(b) Even if the regulations are applicable and even if it were possible to classify a portion of petitioners' business as "mutual" so as to bring it within Section 207, then petitioners would nevertheless fail to qualify for the deduction sought herein. Section 207 (c) (3) of the 1934 Act provides as follows:[4]

> SEC. 207. MUTUAL INSURANCE COMPANIES OTHER THAN LIFE.
>
> * * * * *
>
> (c) *Deductions.*—In addition to the deductions allowed to corporations by section 23 the following deductions to insurance companies shall also be allowed, unless otherwise allowed—
>
> * * * * *

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[4] The corresponding provisions in the 1928 and 1932 Revenue Acts are found in Section 208(c) (3) of those Acts.

> (3) *Mutual insurance companies other than life and marine.*—In the case of mutual insurance companies (including interinsurers and reciprocal underwriters, but not including mutual or mutual marine insurance companies) requiring their members to make premium deposits to provide for losses and expenses, the amount of premium deposits returned to their policyholders and the amount of premium deposits retained for the payment of losses, expenses, and reinsurance reserves.

Petitioners seek to deduct amounts for each year which were added to the so-called contingent reserve and which they assert were amounts "of premium deposits retained for the payment of losses, expenses, and reinsurance reserves." But petitioners have failed to show that the so-called contingent reserve meets these requirements. Petitioners have maintained other adequate reserves for unearned premiums, losses, reinsurance, and other liabilities, and the Commissioner has already allowed appropriate deductions for such reserves. And for aught that may appear the "contingent reserve" is nothing more than a euphemism for an additional surplus account. The net amount added to the "contingent reserve" was merely income remaining after deducting expenses, losses, refunds to policyholders, etc. (R. 23–24, 80–81, 137–138), which might normally be added to surplus available for distribution in the form of dividends to its sole stockholder. True,

no such dividends were paid, but the power to declare them existed then as it presumably continues to exist now, and it is wholly a matter of conjecture as to what will be the ultimate disposition of such funds. Therefore, even if the business of petitioners may be classified as "mutual" under Section 207, pursuant to the regulations, the deduction sought herein is nevertheless not available to petitioners under those provisions.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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FEBRUARY 1942.

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS.

The following organizations shall be exempt from taxation under this title—

* * * * *

(11) Farmers' or other mutual hail, cyclone, casualty, or fire insurance companies or associations (including interinsurers and reciprocal underwriters) the income of which is used or held for the purpose of paying losses or expenses;

* * * * *

(U. S. C., Title 26, Sec. 101.)

SEC. 204. INSURANCE COMPANIES OTHER THAN LIFE OR MUTUAL.

(a) *Imposition of Tax.*—In lieu of the tax imposed by section 13 of this title, there shall be levied, collected, and paid for each taxable year upon the net income of every insurance company (other than a life or mutual insurance company) a tax as follows:

(1) In the case of such a domestic insurance company, 13¾ per centum of the amount of its net income in excess of the credit provided in subsection (f) of this section;

* * * * *

(b) *Definition of Income, Etc.*—In the case of an insurance company subject to the tax imposed by this section—

(1) *Gross Income.*—"Gross income" means the sum of (A) the combined gross amount earned during the taxable year, from investment income and from underwriting income as provided in this subsection, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners, and (B) gain during the taxable year from the sale or other disposition of property, and (C) all other items constituting gross income under section 22;

(2) *Net Income.*—"Net income" means the gross income as defined in paragraph (1) of this subsection less the deductions allowed by subsection (c) of this section;

(3) *Investment Income.*—"Investment income" means the gross amount of income earned during the taxable year from interest, dividends, and rents, computed as follows:

To all interest, dividends and rents received during the taxable year, add interest, dividends and rents due and accrued at the end of the taxable year, and deduct all interest, dividends and rents due and accrued at the end of the preceding taxable year;

(4) *Underwriting Income.*—"Underwriting income" means the premiums earned on insurance contracts during the taxable year less losses incurred and expenses incurred;

(5) *Premiums Earned.*—"Premiums earned on insurance contracts during the taxable year" means an amount computed as follows:

From the amount of gross premiums written on insurance contracts during the

taxable year, deduct return premiums and premiums paid for reinsurance. To the result so obtained add unearned premiums on outstanding business at the end of the preceding taxable year and deduct unearned premiums on outstanding business at the end of the taxable year;

(6) *Losses Incurred.*—"Losses incurred" means losses incurred during the taxable year on insurance contracts, computed as follows:

To losses paid during the taxable year, add salvage and reinsurance recoverable outstanding at the end of the preceding taxable year, and deduct salvage and reinsurance recoverable outstanding at the end of the taxable year. To the result so obtained add all unpaid losses outstanding at the end of the taxable year and deduct unpaid losses outstanding at the end of the preceding taxable year;

(7) *Expenses Incurred.*—"Expenses incurred" means all expenses shown on the annual statement approved by the National Convention of Insurance Commissioners, and shall be computed as follows:

To all expenses paid during the taxable year add expenses unpaid at the end of the taxable year and deduct expenses unpaid at the end of the preceding taxable year. For the purpose of computing the net income subject to the tax imposed by this section there shall be deducted from expenses incurred as defined in this paragraph all expenses incurred which are not allowed as deductions by subsection (c) of this section.

(c) *Deductions Allowed.*—In computing the net income of an insurance company

subject to the tax imposed by this section there shall be allowed as deductions:

(1) All ordinary and necessary expenses incurred, as provided in section 23 (a);

(2) All interest as provided in section 23 (b);

(3) Taxes as provided in section 23 (c);

(4) Losses incurred as defined in subsection (b) (6) of this section;

(5) Subject to the limitation contained in section 117 (d), losses sustained during the taxable year from the sale or other disposition of property;

(6) Bad debts in the nature of agency balances and bills receivable ascertained to be worthless and charged off within the taxable year;

(7) The amount received as dividends from corporations as provided in section 23 (p);

(8) The amount of interest earned during the taxable year which under section 22 (b) (4) is excluded from gross income;

(9) A reasonable allowance for the exhaustion, wear and tear of property, as provided in section 23 (l).

* * * * *

(e) *Double Deductions.*—Nothing in this section shall be construed to permit the same item to be twice deducted.

* * * * *

(U. S. C., Title 26, Sec. 204.)

SEC. 207. MUTUAL INSURANCE COMPANIES OTHER THAN LIFE.

(a) *Application of Title.*—Mutual insurance companies, other than life insurance companies, shall be taxable in the same manner as other corporations, except as hereinafter provided in this section.

(b) *Gross Income.*—Mutual marine-insurance companies shall include in gross income the gross premiums collected and received by them less amounts paid for reinsurance.

(c) *Deductions.*—In addition to the deductions allowed to corporations by section 23 the following deductions to insurance companies shall also be allowed, unless otherwise allowed—

(1) *Mutual insurance companies other than life insurance.*—In the case of mutual insurance companies other than life insurance companies—

(A) the net addition required by law to be made within the taxable year to reserve funds (including in the case of assessment insurance companies the actual deposit of sums with State or Territorial officers pursuant to law as additions to guarantee or reserve funds); and

(B) the sums other than dividends paid within the taxable year on policy and annuity contracts.

(2) *Mutual marine insurance companies.*—In the case of mutual marine insurance companies, in addition to the deductions allowed in paragraph (1) of this subsection, unless otherwise allowed, amounts repaid to policyholders on account of premiums previously paid by them, and interest paid upon such amounts between the ascertainment and the payment thereof;

(3) *Mutual insurance companies other than life and marine.*—In the case of mutual insurance companies (including interinsurers and reciprocal underwriters, but not including mutual life or mutual marine insurance companies) requiring their members to make premium deposits to provide

for losses and expenses, the amount of premium deposits returned to their policyholders and the amount of premium deposits retained for the payment of losses, expenses, and reinsurance reserves.

(U. S. C., Title 26, Sec. 207.)

Section 103 (11) of the Revenue Act of 1928, c. 852, 45 Stat. 791, and of the Revenue Act of 1932, c. 209, 47 Stat. 169, is identical with Section 101 (11), Revenue Act of 1934, *supra*.

Section 204 of the Revenue Acts of 1928 and 1932, except as to rate of tax in the 1928 Act, is substantially identical with Section 204, Revenue Act of 1934, *supra*.

Section 208 of the Revenue Acts of 1928 and 1932 is identical with Section 207, Revenue Act of 1934, *supra*.

Treasury Decision 4697, XV-2 Cum. Bull. 167 (1936) provides:

> Article 207-1 of Regulations 86 is hereby revoked and in lieu thereof there are hereby prescribed the following regulations:
>
> Art. 207-1. *Gross income of mutual insurance companies other than life.*—The gross income of mutual insurance companies (other than life) consists of their total revenue from the operation of the business and of their income from all other sources within the taxable year, except as otherwise provided by the Act. Gross income includes net premiums (that is, gross premiums less returned premiums on policies canceled and premiums on policies not taken), investment income, profits from the sale of assets, and all gains, profits, and income reported to the State insurance departments, except income specifically ex-

empt from tax. Premiums received by mutual marine insurance companies which are paid out for reinsurance should be eliminated from gross income and the payments for reinsurance from disbursements. Deposit premiums on perpetual risks received and returned by mutual fire insurance companies should be treated in the same manner, as no reserve will be recognized covering liability for such deposits. The earnings on such deposits, including such portion, if any, of the deposits as is not returned to the policyholders upon cancellation of the policies, must be included in the gross income. A net decrease in reserve funds required by law within the taxable year must be included in the gross income to the extent that such funds are released to the general uses of the company and increase its free assets. Any net decrease in reserves shall be added to the gross income, unless the company shall show that such decrease resulted from the application of reserves to the purposes for which they were established.

Art. 207–2. *Deductions allowed mutual insurance companies other than life insurance companies.*—Mutual insurance companies (other than life insurance companies) are entitled to the same deductions from gross income as other corporations, and also to the deduction of the net addition required by law to be made within the taxable year to reserve funds and of the sums other than dividends paid within the taxable year on policy and annuity contracts. As to life insurance companies, see sections 201–203 and articles 201 (a)–1–203 (c)–1. Insurance companies, other than mutual and life companies, are entitled only to the deduc-

tions allowed by section 204 (c). (See article 204 (c)–1.) Mutual insurance companies are not entitled to the deductions allowed by section 204 (c), but (except in the case of life insurance companies) are entitled to the deductions allowed by section 23. "Paid" includes "accrued" or "incurred" (construed according to the method of accounting upon the basis of which the net income is computed) during the taxable year, but does not include any estimate for losses incurred but not reported during the taxable year.

Art. 207–3. *Required addition to reserve funds of mutual insurance companies.*— Mutual insurance companies, other than life insurance companies, may deduct from gross income the net addition required by law to be made within the taxable year to reserve funds, including in the case of assessment insurance companies the actual deposit of sums with State or Territorial officers pursuant to law as additions to guarantee or reserve funds. Reserve funds "required by law" include not only reserves required by express statutory provisions but also reserves required by the rules and regulations of State insurance departments when promulgated in the exercise of an appropriate power conferred by statute, but do not include assets required to be held for the ordinary running expenses of the business, such as taxes, salaries, reinsurance, and unpaid brokerage. Only reserves commonly recognized as reserve funds in insurance accounting are to be taken into consideration in computing the net addition to reserve funds required by law. In the case of a fire insurance company the only reserve fund commonly recognized is the "unearned-

premium" fund. For a general definition of "reserve fund" see article 203 (a) (2)–1. Mutual hail and mutual cyclone insurance companies are entitled to deduct from gross income the net addition which they are required to make to the "guarantee surplus" fund or similar fund.

Art. 207–4. *Special deductions allowed mutual marine insurance companies.*—Mutual marine insurance companies should include in gross income the gross premiums collected and received by them less amounts paid for reinsurance. They may deduct from gross income amounts repaid to policyholders on account of premiums previously paid by them, together with the interest actually paid upon such amounts between the date of ascertainment and the date of payment thereof. The remainder of the premiums accordingly forms part of the net income of the company, except to the extent that it is subject to the deductions allowed such insurance companies and other corporations.

Art. 207–5. *Special deductions allowed mutual insurance companies.*—Mutual insurance companies (including interinsurers and reciprocal underwriters, but not including mutual life and mutual marine insurance companies), which require their members to make premium deposits to provide for losses and expenses, are allowed to deduct from gross income the aggregate amount of premium deposits returned to their policyholders or retained for the payment of losses, expenses, and reinsurance reserves. In determining the amount of premium deposits retained by a mutual fire or mutual casualty insurance company for the payment of losses, expenses, and rein-

surance reserves, it will be presumed that losses and expenses have been paid out of earnings and profits other than premiums to the extent of such earnings and profits. If, however, any portion of such amount is applied during the taxable year to the payment of losses, expenses, or reinsurance reserves, for which a separate allowance is taken, then such portion is not deductible; and if any portion of such amount for which an allowance is taken is subsequently applied to the payment of expenses, losses, or reinsurance reserves, then such payment can not be separately deducted. The amount of premium deposits retained for the payment of expenses and losses, and the amount of such expenses and losses, may not both be deducted. A company which invests part of the premium deposits so retained by it in interest-bearing securities may nevertheless deduct such part, but not the interest received on such securities. A mutual fire insurance company which has a guaranty capital is taxed like other mutual fire insurance companies. A stock fire insurance company, operated on the mutual plan to the extent of paying dividends to certain classes of policyholders, may make a return on the same basis as a mutual fire insurance company with respect to its business conducted on the mutual plan.

Art. 207–6. *Returns of insurance companies.*—Insurance companies transacting business in the United States or deriving any income from sources therein are required to file returns of income. The return shall be on Form 1120, except that life insurance companies shall make return on Form 1120L. As an aid in auditing the returns, wherever possible a copy of the re-

port to the State insurance department should be submitted with the return. Otherwise a copy of Schedule D, parts 1, 3, and 4, of the report should be attached to the return, showing the Federal, State, and municipal obligations from which the interest omitted from gross income was derived, and a copy of the complete report should be furnished as soon as ready for filing.

The above is substantially the same as Articles 1001–1015 of Treasury Regulations 74 and 77, promulgated under the provisions of the Revenue Acts of 1928 and 1932, respectively.

U. S. GOVERNMENT PRINTING OFFICE: 1942